

December 16, 2004

The Honorable Frank H. Murkowski, Governor
Members of the Alaska State Legislature
Teachers' Retirement Board
Alaska State Pension Investment Board
Employers and Plan Members of the System

We are pleased to present the Comprehensive Annual Financial Report (CAFR) of the Teachers' Retirement System (TRS) (System) for the fiscal year ended June 30, 2004.

This report is intended to provide comprehensive information on the financial operations of the System for the year. Responsibility for both the accuracy of the data, and the completeness and fairness of the presentation, including all disclosures, rests with the management of the System. To the best of our knowledge and belief, the enclosed data is accurate in all material respects and is reported in a manner designed to present fairly the financial position and results of operations of the System for the year ended June 30, 2004. All disclosures necessary to enable the reader to gain an understanding of the System's activities have been included.

For financial reporting purposes, the System utilizes Governmental Accounting Standards Board (GASB) Statement No. 25, *Financial Reporting for Defined Benefit Pension Plans and Note Disclosures for Defined Contribution Plans*; GASB Statement No. 34, *Basic Financial Statements – and Management's Discussion and Analysis – for State and Local Governments*; GASB Statement No. 37, *Basic Financial Statements – and Management's Discussion and Analysis – for State and Local Governments: Omnibus*; and GASB Statement No. 38, *Certain Financial Statement Note Disclosures*. Assets of the System are presented at fair value. The actuarial value of assets and the actuarial accrued liability are presented in the required supplementary information following the notes to the financial statements.

The FY 2004 CAFR is divided into five sections:

- **Introductory Section**, which contains this letter of transmittal, the administrative organization of the System, and a list of the members serving on the Teachers' Retirement Board;
- **Financial Section**, which contains the Independent Auditors' Report, management's discussion and analysis (MD&A), basic financial statements, required supplementary information, and additional information;
- **Investment Section**, which contains a message from the Chair of the Alaska State Pension Investment Board (ASPIB), a list of members serving on the ASPIB, a report on investment activity, investment results, and various investment schedules;
- **Actuarial Section**, which contains the Actuarial Certification letter and the results of the most current (June 30, 2003) annual actuarial valuation; and
- **Statistical Section**, which includes graphs and tables of significant data.

The Alaska TRS was established in 1955 to provide pension and postemployment healthcare benefits for teachers and other eligible participants. Normal service, survivor, and disability benefits are available to all members who attain the age and service requirements of the System.

	TRS		
	FY04	FY03	FY02
Net Assets (millions)	\$3,911.5	3,602.6	3,689.0
Participating Employers	58	57	57

Reporting Entity

The System is considered a component unit of the State of Alaska for financial reporting purposes. Because of the closeness of the System's relationship to the State, it is included in the State of Alaska CAFR as a blended component unit.

The Commissioner of the Department of Administration, appointed by the Governor, is responsible for administering the System. In order to meet the statutory requirements of administering the System, the Commissioner appoints the Director of the Division of Retirement and Benefits. The Director is responsible for the daily operations of the System.

The Teachers' Retirement Board prescribes policies and regulations, hears appeals, and approves employers' contribution rates prepared by the System's independent actuary.

The ASPIB has statutory oversight of the System's investments and the authority to invest the System's monies. Actual investing is performed by external investment firms and investment officers of the Department of Revenue, Treasury Division, listed in the Investment Section of this report. The Treasury Division is responsible for carrying out investment policies established by ASPIB.

Major Initiatives

The System continues to make progress on completing several on-going projects. Most of these efforts focused on improvements in technology, improving methods for members to obtain information about the System and their benefits, and continued compliance with accounting requirements of the Governmental Accounting Standards Board (GASB) and the Financial Accounting Standards Board (FASB) as applicable in the circumstances.

The Public Employees' and Teachers' Retirement Boards have been looking at ways to reduce costs to the employers and address the underfunded status of the Systems while also balancing the need to provide adequate benefits in order to effectively recruit and retain new members. A "Tier subcommittee" was developed to look at the possibility of adding a Tier IV in the PERS and a Tier III in the TRS. These new tiers would provide pension and postemployment healthcare benefits at levels the same as or less than current tiers. The Tier subcommittee has been meeting for almost a year and surveyed employers, employees, and benchmarked current Tiers with other states pension benefits. In order to accomplish this project, the Tier subcommittee used the services of the System's actuarial consultant to review and analyze the results of the study and determine the impact on the Systems. The Tier subcommittee did make a formal recommendation to the respective boards in November 2004.

Independent Audit

The System's annual audit was conducted by the independent accounting firm of KPMG LLP. The auditors' report on the basic financial statements is included in the Financial Section of this report.

Actuarial Valuation

An actuarial valuation of the System is performed annually. An assumption experience study is performed at least every other year. The System's actuarial firm, Mercer Human Resource Consulting, completed the actuarial reviews and valuations as of June 30, 2003, and served as technical advisor to the System. Actuarial certifications and supporting statistics are included in the Actuarial and Statistical Sections of this report.

Professional Services

Professional consultants are retained to perform professional services that are essential to the effective and efficient operation of the System. A list of consultants is provided in the Introductory Section with the exception of investment professional consultants, who are listed in the Investment Section of this report.

Certificate of Achievement

The Government Finance Officers Association of the United States and Canada (GFOA) awarded a Certificate of Achievement for Excellence in Financial Reporting to the Alaska Teachers' Retirement System for its comprehensive annual financial report for the fiscal year ended June 30, 2003. In order to be awarded a Certificate of Achievement, a government must publish an easily readable and efficiently organized comprehensive annual financial report. This report must satisfy both generally accepted accounting principles and applicable legal requirements.

A Certificate of Achievement is valid for a period of one year only. We are confident that our current comprehensive annual financial report continues to meet the Certificate of Achievement Program's requirements. Therefore, we are submitting it to the GFOA to determine its eligibility for another certificate.

Future Employer Contribution Rates

The System's consulting actuary presented the results of the June 30, 2003 actuarial valuation report to the administrator and the board. The assumptions and benefits are explained in the Actuarial Section of this report.

Based on this most recent valuation report, the System has a funding ratio (assets of the System divided by the total liabilities for pension and postemployment healthcare) of 64.3%. The unfunded portion of the System's liabilities totals approximately \$2.1 billion. The unfunded liability is amortized over a 25 year period, as established by the Board. In order to bridge the gap between assets and liabilities of the System, the employer matching contribution rate would increase over the same 25 year period from the Fiscal Year 2004 rate of 12% to approximately 48% in Fiscal Year 2028 if the System earns the assumed rate of 8.25%. The current asset allocation that the Alaska State Pension Investment Board for the System's investments is expected to provide a five year median return of 7.72%.

While investment returns in Fiscal Year 2004 of 15.09% exceeded the actuarial assumed rate of 8.25%, one good year does not make up for the three prior years of earnings less than the assumed rate. Any time the System earns less than the assumed 8.25%, the impact typically will be an increase to the employer

matching contribution rate. Since the three prior years rates were less than the assumed rate by 4.57% to 13.74%, these differences severely impacted the funding ratios, which in turn results in increased rates to the employers.

Besides the obvious impact of investments, the System also experienced significant increases in healthcare costs. In order to properly accrue (build up) assets to pay for the future "more expensive" health benefits, the System needs to charge employers a higher rate to offset those costs. The System has assumptions in place to account for healthcare costs, but if cost increases exceed what the System assumes, the impact is to increase the employer matching contribution rate.

For additional information on how a defined benefit system like TRS operates, the Division has developed a "white paper" that describes how the System is funded by revenues from plan members, employers, and investments, and where System costs are. This "white paper" is titled "Employee Benefits and Retirement System Funding" and is located at www.state.ak.us/drb/trs/trspublications.htm.

Currently, the Alaska PERS and TRS are rare in that these plans constitute two out of eight retirement systems that pre-fund and account for medical costs. The other three states that do this are Ohio, Michigan and Kentucky. The PERS and TRS systems are fortunate in that the creators and administrators of the Systems had foresight to fund the healthcare costs in advance. The remaining 120 other major governmental retirement systems only account for their current annual liability for healthcare costs. Once GASB #45 is effective in 2006/2007, all retirement systems will have to account for their future healthcare costs, similar to what our System already reports. So, current comparisons to other systems will be comparable once other systems start reporting their liabilities like PERS and TRS.

Acknowledgments

The preparation of this report is made possible by the dedicated service of the staff of the System. It is intended to provide complete and reliable information as a basis for making management decisions, as a means of determining compliance with legal provisions, and as a means of determining responsible stewardship of the funds of the system.

The report is being mailed to all employer members of the System. They form the link between the System and the membership. Their cooperation contributes significantly to the success of the System. We hope the employers and their employees find this report informative.

We would like to take this opportunity to express our gratitude to the Teachers' Retirement Board, the Alaska State Pension Investment Board, the staff, the advisors, and to the many people who have worked so diligently to assure the successful operation of the System.



Ray Matiasowski, Commissioner



Kevin Brooks, Deputy Commissioner



Kevin Worley, CPA, Defined Benefits Accounting Supervisor

Respectfully submitted,



Melanie Millhorn, Director



Anselm Staack, CPA, JD, Chief Financial Officer

Certificate of Achievement for Excellence in Financial Reporting

Presented to

Alaska Teachers' Retirement System

For its Comprehensive Annual
Financial Report
for the Fiscal Year Ended
June 30, 2003

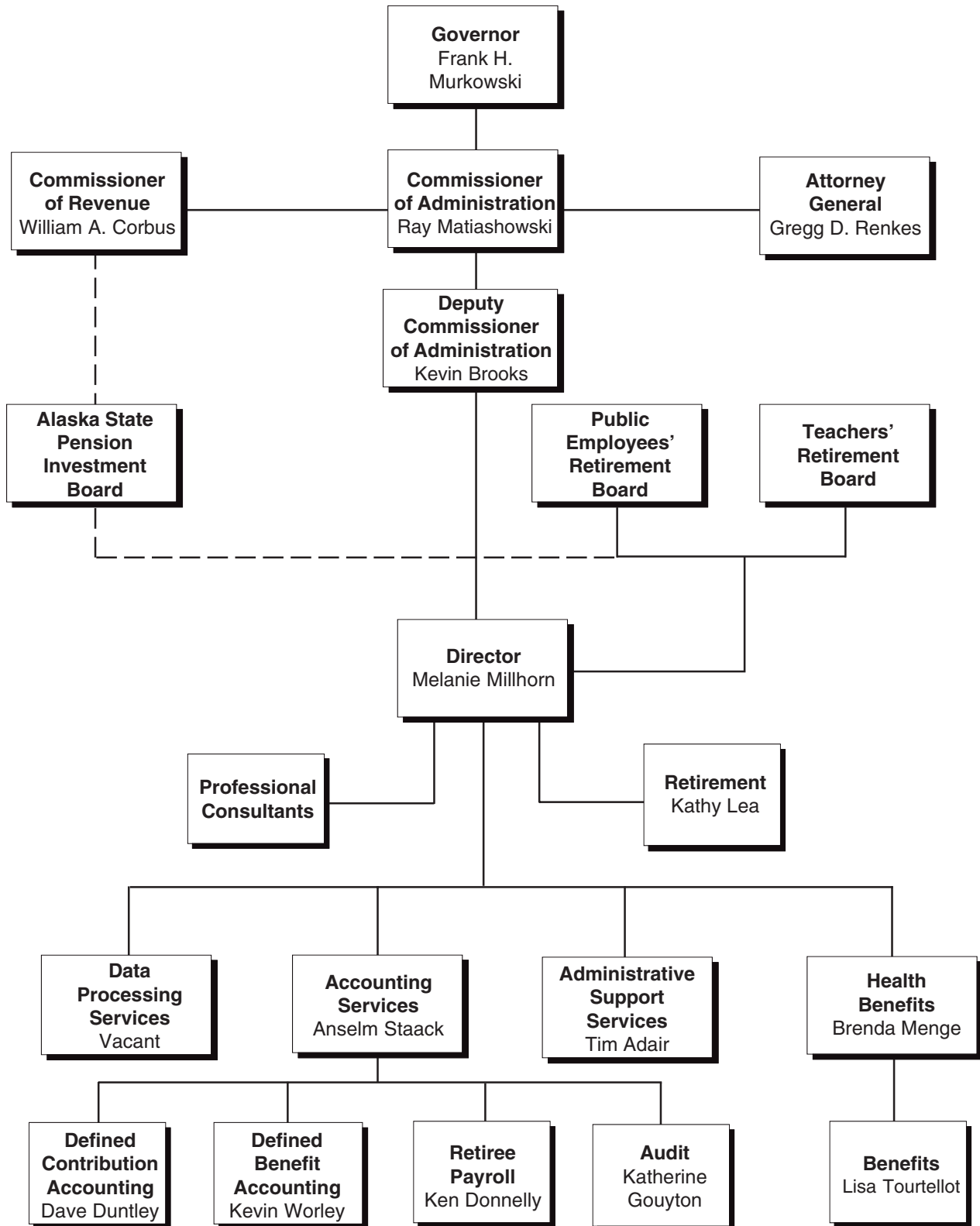
A Certificate of Achievement for Excellence in Financial Reporting is presented by the Government Finance Officers Association of the United States and Canada to government units and public employee retirement systems whose comprehensive annual financial reports (CAFRs) achieve the highest standards in government accounting and financial reporting.



President

Executive Director

ORGANIZATION CHART



Section Responsibilities

The **Retirement Section** is responsible for providing comprehensive retirement counseling to the participating members and employers in the plan. The section appoints members to retirement benefits and maintains benefit payment information.

The **Benefits Section** is responsible for the administration of group health, disability, and life insurance. This section provides benefits counseling and plan change information to the membership.

The **Defined Benefit Accounting Section** is responsible for maintaining the employee and employer records and accounts in each of the defined benefit plans administered by the Division, producing financial statements and reports, and assuring compliance with the Internal Revenue Service requirements for defined benefit plans.

The **Defined Contribution Accounting Section** is responsible for accounting, plan operations, and financial activities related to the defined contribution plan systems administered by the Division.

The **Data Processing Services Section** supports the information systems the Systems use. Responsibilities include planning, development, data base design, programming, and operational support of the data processing systems, including the Local Area Network.

The **Administrative Support Services Section** is responsible for budget preparation, fiscal management of appropriations, procurement of professional services, supplies, and equipment. The section manages the Systems' record center containing the members' physical records and performs other administrative functions, such as legislative tracking and personnel management.

The **Retiree Payroll Section** is responsible for issuing monthly and on demand retirement benefit payments to eligible retirees or their beneficiaries. The section maintains accurate records for reporting benefit recipient tax statements and reporting and paying withheld income taxes, garnishments, and IRS levies.

PROFESSIONAL CONSULTANTS	
Consulting Actuary Mercer Human Resource Consulting <i>Seattle, Washington</i>	Legal Counsel Virginia Ragle Kathleen Strasbaugh Assistant Attorney Generals <i>Juneau, Alaska</i>
Independent Auditors KPMG LLP <i>Anchorage, Alaska</i>	Legal Counsel - Retirement Boards Wohlforth, Vassar, Johnson & Brecht <i>Anchorage, Alaska</i>
Benefits Consultant Deloitte & Touche, LLP <i>Minneapolis, Minnesota</i>	Consulting Physicians Kim Smith, M.D. William Cole, M.D. <i>Juneau, Alaska</i>
Third Party Health Claim Administrator Aetna Life Insurance Company <i>Walnut Creek, California</i>	

A list of external money managers and consultants for the System can be found on pages 50-51, and the Schedule of Investment Management Fees on pages 57-58.

TEACHERS' RETIREMENT BOARD

(as of June 30, 2004)



Charlie Arteaga, Chair

Term Expires: January 31, 2005

Charlie Arteaga has been an Alaskan resident for 33 years. He resides in Ketchikan. He received his Bachelor's in Education at Arizona State University and his Masters in Counseling at the University of Oregon. He was an educator with the Ketchikan Gateway Borough School District until 1996.

Mr. Arteaga was appointed to the Teachers' Retirement Board by Governor Tony Knowles. He is now employed in other sectors of public service and tourism. He intends to remain an active Alaskan citizen.



Gayle W. Harbo, Vice Chair

Term Expires: June 30, 2005

Gayle Harbo arrived in Alaska in 1957, married Sam Harbo in 1958, and lived in Cold Bay, Juneau and Nome before settling in Fairbanks in 1962. She graduated from North Carolina State University in Raleigh with a BS in Mathematics and earned a Master of Arts in Teaching at the University of Alaska-Fairbanks. She taught at Lathrop High School for most of her twenty-five years in the Fairbanks District and served as coordinator of the school's Advanced Placement Program and on the District's Curriculum Committee. She worked on committees which wrote the evaluation documents used by the district and served on several budget committees. Since retiring in 1993, she has enjoyed traveling with her husband and assisting him with several building projects for each of their four children. She loves her home and garden and the opportunity to take care of any or all of their seven grandchildren.



Richard J. Solie, Sr.

Term Expires: January 31, 2007

Richard Solie has been an Alaska resident for 33 years. He received his Bachelor's degree from the University of Wisconsin, Superior, and his Ph.D. degree in Economics from the University of Tennessee. After seven years of teaching in the "Lower 48", he served as Professor of Economics, Head of the Department of Economics, and Acting Dean of the School of Management at the University of Alaska, Fairbanks during the period from 1970-1986. Following his retirement from UAF, he was self-employed in his own economic consulting firm. He and his wife, Elsie, live in Fairbanks along with their four children and ten grandchildren.



Robert G. Boko

Term Expires: June 30, 2005

Robert Boko was born and educated in Bridgeport, Connecticut. He later moved to Washington State where he received a BA in Music & Music Education from Western Washington University. After volunteering for the draft, serving in the Korean war and receiving the Bronze Star Medal with the 7th Infantry Division, he returned to the U.S. and taught instrumental music in Seattle in 1954. He later earned a Master of Arts degree from Teacher's College Columbia University in New York City. In 1956, Robert took a position in Kodiak teaching music to grades 7 through 12, then moved to Fairbanks in 1959. During his time in Fairbanks, Robert began an All-State Band, Orchestra and Choir. Today this program is one of the most successful events for students throughout the State. He has been a teacher and administrator in the Fairbanks North Star Borough School District. Upon retiring from the district, he worked as an adjunct staff member at UAF, supervising student teachers throughout the State. Robert has been a member of the Fairbanks School board and a board member for Mount Edgecumbe High School in Sitka. Over the past seven years, Robert has been working with students in festival and clinic settings in Western Alaska, South Central & the Interior. For the past six years, he has been a councilman for the City of Fairbanks. In his spare time, Robert is the music director & conductor of the Fairbanks Community Band in addition to serving on several local boards.



Dick Schulz

Term Expires: January 31, 2006

Dick Shultz moved to Alaska in 1970 from Anselmo, a small town in central Nebraska. He settled in Mentasta Lake, a remote native village southwest of Tok where he taught kindergarten through the eighth grade. Dick relocated to Northway and taught there for five years after which his career took him to Delta-Greely as a school guidance counselor. In 1978, Dick returned to rural teaching in Nabesna until 1980, when he returned to the Delta-Greely School District as the assistant superintendent.

Dick left his career in education in 1982 when he was elected to the House of Representatives for District 17. He served in the legislature for ten years, eight as a representative and two as a senator until he retired from public service in 1992. Dick and his wife live in a rustic setting near Tok, where he enjoys life as an avid outdoorsman.

Dick was appointed to serve on the Teachers' Retirement Board by Governor Murkowski and he is looking forward to serving. He says, "I have always been concerned about maintaining the integrity of the fund to insure future retirees that their system will be able to provide stable retirement benefits."

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